



LOCAL GOVERNMENT FINANCE

REPORT OF THE COMMITTEE
OF ENQUIRY

Chairman

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*Presented to Parliament by
the Secretary of State for the Environment,
the Secretary of State for Scotland and
the Secretary of State for Wales
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which incur the greater expenditure in relation to population. Rates should also be levied by metropolitan counties and non-metropolitan and Scottish districts. This would permit a considerable range of choice for the respective contributions of LIT, rating and grants. There may be a need for the government to determine the broad proportions each local tax should bear.

82. The alternative of making LIT a sole source of local revenue for the major spending authorities and rating for other authorities would make for very clear accountability, but would severely limit the use of rating and put a strain on national taxation.

83. Special arrangements would be needed to bring London within the national arrangements.

CHAPTER 15

Proposals

THE NEED FOR A COHERENT SYSTEM

1. When he announced the setting up of our inquiry, the Secretary of State for the Environment made it clear that we would be concerned not with interim problems of local government finance but with the long-term issues. Our inquiry was commissioned following the outcry against the unprecedented increases in rate demands in England and Wales in 1974. Complaints about rate increases were accompanied by widespread concern about the growth of local government expenditure. The immediate crisis was caused by a combination of factors which together would have placed an immense strain on any financial system and exposed any weaknesses in it. What the crisis exposed, however, was not simply the weak points in an otherwise sound system, but a collection of financial arrangements whose objectives were not clear and which had never been properly related to each other. The measures we consider to be required, therefore, are not merely adjustments to the present arrangements and palliatives to meet particular complaints, but the construction of a financial system.

2. The system should be based on accountability: whoever is responsible for spending money should also be responsible for raising it so that the amount of expenditure is subject to democratic control. The results should be fair both between individuals and between local authority areas. The financial arrangements should bring home to those taking decisions the economic implications of the choice between consumption and investment. They should also promote efficiency in the provision of services. The arrangements should be stable, flexible and comprehensible. These requirements cannot all be equally satisfied, but they are criteria against which any financial system for local government must be judged. The Redcliffe-Maud and Wheatley Royal Commissions were not asked to examine local government finance and the form of local government reorganisation was decided without a comprehensive review of the scope that it offered for new financial arrangements. As a result, a variety of two-tier organisations was adopted with diverse and overlapping responsibilities which present serious obstacles to the creation of a financial system providing clear accountability.

3. The financial system should reflect the roles of the government and local authorities. The government is responsible for the overall management of the economy. It is concerned with the level of output and employment, the balance

of payments, the level of wages and prices, and the distribution of income and welfare. It needs to be able to ensure that changes in public expenditure, including local government expenditure which accounts for over a third of it, do not prejudice its economic objectives. The government is also concerned with the services for which local authorities are responsible, but control over their individual development is not essential for the purposes of economic management. The government now uses instruments designed for one purpose to achieve other purposes as well. It often appears to be pursuing conflicting objectives. As a result there is no clear control over local government expenditure and there is confusion over who is responsible.

4. The role of local government is to enable decisions to be taken democratically to cater for local needs and preferences. It was one of the purposes of local government reorganisation to strengthen this role, but in practice it has continued to be eroded. How effectively local authorities will be able to discharge it in future depends on how much responsibility governments are prepared to let them have.

5. A financial system is not an end in itself but a means of achieving social and political purposes which lie beyond the scope of our inquiry. There is no simple solution. Choices have to be made.

6. The present arrangements have grown up over a very long period. Most of them have their origins in the last century and some go back even further. In reaching our conclusions we have been greatly influenced by the events of the last three years. But we have tried to consider them in perspective. It is not our main task to solve the immediate problems that currently face the government and local authorities. The frequency of change, especially in the last decade, has itself contributed to the difficulties we have observed, falsifying expectations, increasing administrative costs and dislocating the planning of resources. Although we make some proposals for early implementation our proposals are mainly of a long-term nature. Our inquiry is the first comprehensive review since 1914. Fundamental changes are needed with the aim of creating a durable system based on arrangements which are suitable for their purposes and consistent with one another. Many of the difficulties are of long standing. They cannot be quickly or easily overcome.

SOURCES OF REVENUE

7. The total cost of local services which has to be met from taxation in 1975/76 is £11,500 million. There are two separate issues to be considered in deciding how this expenditure should be paid for. The first is the final incidence of taxation, that is the relative burden of taxation on different classes of taxpayer and different income groups. The second is how much of that taxation should be levied by the government through the national taxation system and how much by local authorities from local taxes. In the past the two issues have had

to be considered together because local authorities have only one major source of taxation so the question of how much taxation should be raised by local authorities could not be divorced from the impact of the rating system.

8. Rating forms a major element in the total taxation system, with a yield of over £4,000 million in 1975/76. There is a good case in principle for a tax on property, which is particularly suitable as a local tax. But the overall effects of a tax on domestic property, matched by the payment of a similar amount from public funds in reliefs and subsidies for housing, need to be considered in the current review of housing finance in order to ensure that in future the totality of the measures forms part of a coherent and equitable strategy. We have examined the effects of rating compared with other taxes and we have come to the conclusion that the abolition of rating would not be justified in terms of improving the incidence of taxation. Moreover, it is necessary to retain rating as a local tax in order to provide all district councils with a tax of their own. We consider that it is necessary to retain the rating of non-domestic as well as domestic property in order to preserve the financial link between local authorities and industry and commerce in their areas that recognises their complementary interests.

9. For about 4½ million households the inherent regressiveness and unevenness of domestic rating is mitigated by the rebate scheme and supplementary benefits which relate rate payments to income and family circumstances. It would be neither practicable nor consistent with the nature of the tax to go further in this direction, for example by relating rate payments to the number of income-earners in each household. Although non-domestic rating can be made more consistent in its application, the unevenness and uncertainty of its effects restrict the contribution it can make to local taxation. Generally, while rating can continue to provide a substantial source of local revenue, we cannot suggest changes in the rating system which would enable it to finance a much bigger share of local government expenditure.

10. It would be practicable to introduce a local income tax provided it were accompanied by some administrative changes in the system of national income tax. We have therefore concluded that there are now two main possibilities: to continue with the present combination of rating and grants or to introduce LIT as an additional source of revenue for those authorities responsible for the services that account for the most expenditure. In either case it would be practicable to reduce the burden of rating, in the one case by increasing grants and in the other by substituting LIT for part of the yield of rating. The resulting change in the incidence of taxation would depend in the first case on how the government chose to raise the revenue to finance increased grants and in the second on the adjustments in the national tax system which would be required to accommodate LIT. In either case the changes would be determined by the government's overall taxation policy. There is therefore likely to be little to choose between the alternatives we have suggested in terms of the resulting

overall incidence of taxation. Whether LIT should be introduced therefore depends on a decision as to how much of that taxation should be levied by the government and how much by local authorities. That decision in turn depends on their respective responsibilities for expenditure. Although the present crisis has been seen by many as a financing crisis, changing the sources of finance will not prevent similar crises from recurring in future unless the new arrangement is founded on a clear definition of responsibility for expenditure.

RESPONSIBILITY FOR EXPENDITURE

11. The need for accountability for local expenditure is fundamental. For this reason we do not favour suggestions that a prescribed share of national taxation should be assigned to local authorities. Assigned revenues have the same characteristics as grants. The government must be accountable to the electorate at large through Parliament for the amount of taxes it raises. It cannot provide local authorities with a preponderant share of their income, whether in the form of assigned revenue or grants, without sooner or later taking responsibility for their expenditure.

12. If local authorities are to exercise discretion over the way they carry out their functions and to determine the level and pattern of expenditure on them, they should be responsible for finding the money through local taxes for which they are accountable. But the government also plays a major part in determining the level and pattern of local government expenditure. Government departments told us that they saw the relationship between central and local government as a partnership, which recognised their shared responsibility. In practice, expenditure is incurred in response to a wide range of pressures from the public, professional opinion and special interest groups which affect both central and local government. At present it is virtually impossible to distinguish their respective responsibilities for expenditure and for this reason there is a lack of clear accountability. We therefore considered a number of ways in which the financial responsibility of central and local government might be separated, so that expenditure arising from the government's decisions could be financed from national taxation and expenditure incurred by local authorities at their own discretion could be separately identified and financed from local taxation.

13. We received many suggestions that services such as education are really national rather than local services and should be paid for out of national taxation. The recognition that part of local authorities' expenditure on services was national in character was one of the original reasons for government grants. But for the government to pay the whole cost of a service would imply that it was wholly national in character. We consider that a service should be financed wholly by the government only if it is considered that there should be no room for local discretion in providing it. Moreover, we think that it would be unsatisfactory for local authorities simultaneously to be responsible

to the government for some of their major services and to their local electorate for others. Such a division of responsibility would impair the ability of local authorities to consider the best balance of provision within their areas as a whole and would introduce distortions in the allocation of resources. The same considerations apply to the suggestion that the whole cost of specific blocks of expenditure, such as teachers' salaries, should be met by the government.

14. We were more attracted to the alternative of drawing a distinction between the cost of meeting national minimum standards, which should be financed out of national taxation, and the provision of higher standards at local discretion, which should be paid for out of local taxation.

15. We took a good deal of evidence and commissioned studies to see whether such a distinction could be drawn in practice. We came to the conclusion that it is not possible at present. There would be major practical problems in any attempt to lay down minimum acceptable standards in future. For most services standards could be defined only in terms of the manpower required or other measures of cost. Defining standards in this way would not be in the interest of efficiency and would not overcome the difficulty of measuring the cost of meeting them in each area. Basing contributions from national taxation on the actual cost of providing services would differ very little from the existing grant system. To provide a satisfactory basis for distinguishing national from local responsibilities, standards would have to be defined for all the major services in terms of the results to be achieved and the necessary cost of meeting them would need to be established in each local authority area. Efforts to measure the output of local services in this way have not so far been very successful. We consider that whatever arrangements are adopted these efforts should be pursued in any event in order to promote efficiency and to help determine the distribution of grant. But a major commitment of resources would be needed to devise such measures and it would be optimistic to expect early results for the bulk of local government expenditure.

16. If these practical difficulties could be overcome, it is difficult to foresee whether a substantial measure of local accountability would ensue. It would be necessary to revise the form of statutes governing local services, which are mostly couched in very general terms. Once minimum standards were statutorily defined, there would need to be some machinery for ensuring compliance with them. Much would depend on how high the minimum standards were set and how they changed over time. The process of defining and revising them would itself tend to focus pressure on the government for their improvement. It would need to be considered whether Ministers would be content to set standards below the current level of provision and keep them stable for long periods, leaving local authorities to determine the pace and direction of growth; or whether they might set the standards high and change them frequently as a means of directing the development of local services. If, as seems possible, the cost of meeting minimum standards were to account for a large proportion

of local government expenditure, a division of financial responsibility on this basis would tend to place the major share of responsibility with the government.

17. In the absence of a clear dividing line between central and local responsibilities, the present confusion can be ended only if the main responsibility for local expenditure and taxation is expressly placed either upon the government or local authorities. The first course would mean accepting the present drift towards central responsibility as inevitable and requiring the government to be more explicitly and formally accountable. No new source of local revenue would be needed but there would have to be significant changes in the organisation and procedures of government departments. The second course would require the introduction of a local income tax to supplement rating as a source of local revenue. But a wider local tax base could not by itself ensure that the present confusion of responsibilities was ended. It would need to be accompanied by the political will to allow local authorities more freedom to decide how to carry out their functions. The implications of this choice have been outlined in the chapters dealing with the individual elements in the financial arrangements. Before we go on to consider how these arrangements can be brought together we shall summarise the features which we consider to be desirable in any financial system and those changes which should be made in any event.

COMMON FEATURES

18. Much of our report is concerned with clarifying the relationship between central and local government. We have placed little emphasis on improving those elements of the present arrangements which do not work satisfactorily. To do so might suggest the present basis for local government finance could be maintained satisfactorily in the longer term, which we do not believe to be the case. Nevertheless, we have identified a number of features which we consider should be included in any arrangements. We describe these briefly below.

Staffing

19. We did not examine the level of staffing in local government. The number of staff required to run services efficiently depends on many local factors and the policies being pursued. The Joint Staff Watch instituted by the Department of the Environment and the local authorities (in Scotland, the Joint Manpower Watch) should make it easier to monitor staff levels in future. The trend of pay and conditions of service of local government employees cannot be expected to differ greatly from those in other sectors of the economy. But information about the cost of changes in conditions of service needs to be improved and their implications for individual local authorities adequately assessed.

New Institutional Arrangements

20. There is a need for a new forum to keep the financial relationship between the government and local authorities under continuous review, to establish

closer contact between those who are concerned with the use of resources at both levels of government, to ensure more realistic estimates of the cost of introducing new legislation, and to ensure the availability of coherent and up-to-date information as a basis for decisions and for monitoring their effects. Its membership should include Ministers and local elected representatives under the chairmanship of a Treasury Minister and it should be served by an office independent of central and local government. It is too early to say how the Consultative Council as constituted at present might develop, but it may be that it could be adapted to fulfil this role.

Improving Financial Administration

21. It is of the greatest importance that there should be adequate safeguards against waste, extravagance and inefficiency. While hospitality, attendance allowances and other expenditure attributable to councillors in the exercise of their functions accounts for only a small fraction of local authorities' budgets, all concerned in local government should recognise their responsibility to ensure that there are adequate internal safeguards against abuse. It is important that local authorities should obtain the maximum value for the money they spend on all their activities. More emphasis in the auditing of local authority accounts should be placed on efficient financial administration and value for money. There should be more systematic studies of the comparative performance of local authorities and periodic major reviews of trends in the use of resources in local authority services. To this end the audit service in England and Wales should be headed by an independent official who, with the advice of an expert panel, should have sole responsibility for the appointment of auditors to local authorities and for the organisation of the audit service. He should make regular reports on issues of general interest or public concern relating to more than one local authority. These reports could be made to a Parliamentary Committee or the new forum we have proposed or to a representative local government body.

22. The Chief Financial Officer of each local authority should be under a statutory obligation to report regularly to the council on defined major financial issues.

Transfer of Financial Responsibility

23. The government should meet the full cost of mandatory student awards, magistrates courts, probation and after care (in England and Wales) and means-tested benefits over which local authorities have no discretion. A new basis for sharing the costs of advanced further education and teacher training should be developed which will provide a closer and more evident relationship between what each authority pays and the benefit it receives.

24. The government should meet the whole cost of the Metropolitan Police unless local authorities in London are enabled to exercise the same control over its expenditure as local authorities exercise over police expenditure elsewhere. We do not recommend that the police service outside London should

be wholly financed by the government. Such a change would have constitutional implications which are not for us to consider.

Capital Finance

25. We do not support suggestions that the government should write off existing loan debt or take over responsibility for its servicing. Nor do we think there should be a major extension of capital grants. Local authorities should continue to be able to finance capital expenditure from borrowing. The proportions in which they borrow from the market and from the Public Works Loan Board should be adjusted according to circumstances. The scale of temporary and short-term borrowing and the consequent need for re-financing should be kept under review. The practice of pooling loans should continue. However, new accounting arrangements should be developed which identify the full cost of using all assets.

Fees and Charging

26. A radical change in the policies for financing local services which would involve charging people to a much greater extent for the individual benefits they enjoy from those services could only be undertaken as part of a deliberate national policy which would not be confined to local government services. But there may well be scope for increasing the proportion of local government revenue derived from charges without any radical change in social policies. There should therefore be a review of policy and practice in charging for local services, to be carried out jointly by the government and local authorities. We have indicated what the aims of such a review should be and some of the considerations which should be taken into account. We have suggested that the accounting arrangements should identify the amount of any subsidy and that the amount of expenditure financed from fees and charges should be made explicit in the grant settlement.

Rating

27. For domestic property in England and Wales the rating system can be maintained only on the basis of capital value. Preparations for a revaluation on this basis should be put in hand as soon as possible. At the next revaluation the residential parts of business premises with living accommodation should be assessed so that those parts do not bear a heavier burden than other comparable domestic property. In Scotland the proposed revaluation should proceed in 1978 as planned and the basis of valuation should be reviewed thereafter.

28. The relative rate burdens of domestic and commercial and industrial properties should be determined by the government, having regard to the burden of rates on both sectors. The relative burden should not be changed between revaluations and that relationship should not be open to change as part of the grant settlement. Rating should be applied to the widest possible range of properties. These should include agricultural land and buildings. The method of assessment of public utilities should be in the hands of an

independent body. Crown property should be assessed in the same way as other similar property, except where there are compelling reasons against. We do not recommend any change in the rating of charities. Where assessments are made on the basis of rental values they should be made direct to net annual value instead of gross value.

29. Frequent and regular revaluations are essential. We propose modifications of the arrangements for appeals against assessments, designed to protect the interests of ratepayers while improving the prospect of regular revaluations. Rate bills should normally be payable by instalments by all ratepayers.

Grants

30. Block grants should remain the principal means of grant aid. Police grants should be included in the block grant and all transport expenditure should in due course be assisted in this way.

31. The distribution of grants should continue to take into account variations between areas in both their spending needs and their tax-raising capacities. Aggregate personal incomes are likely to be a more satisfactory measure of the ability of local authorities to raise money from domestic taxpayers in their area than domestic rateable values. London should as far as practicable be included in the general system of distribution.

32. There should not be marked variations in the distribution of grants to individual authorities from one year to the next. The basis of distribution should be settled at least a year ahead of the current year. Adjustments for changes in pay and prices should not affect this basis.

33. There could be advantage in combining the needs and resources elements of the block grant into a unitary grant, instead of treating them separately.

The Two-Tier System

34. Local taxation should be collected in a way which makes it clearer how much each authority is collecting and for what purposes. All local authorities should receive their own allocation of grant related to their expenditure needs and tax-raising capacity and should be responsible for their own taxation in England and Wales as in Scotland. An appropriate allocation of grant should therefore be made separately to metropolitan counties and non-metropolitan districts. The special problems of grant distribution within London should be considered with the London authorities.

Implementation

35. Some of the changes we have recommended could bring about an early improvement in the present arrangements. Those to which we attach high priority are: setting up a new forum served by an independent office; the reorganisation of the audit service; the review of fees and charges; the introduction of instalments as the normal method of paying rate bills; the early

provision of relief for the residential parts of business premises; the making of earlier grant settlements; and clarification of the responsibility of the two tiers of local government for rate burdens.

36. Other changes we have recommended, especially in the rating system and the distribution of grants, would have a major effect on the finances of individual local authorities and on the burdens borne by individual taxpayers. These changes could be implemented only over a fairly lengthy period, not only in order to bring about the necessary legislative and administrative measures, but also in order to enable those affected by the changes to adjust to them. We are not in a position to work out detailed transitional arrangements. A great deal will depend on what measures and what combination of them are to be introduced, and their detailed application, on changes in the level and incidence of both national and local taxation and on all the other circumstances prevailing at the time the changes are introduced. We draw attention to some of the factors which should be borne in mind when transitional measures are designed. Those measures should be regarded as an important part of the final decisions on the changes to be made.

37. Transitional arrangements can be of two kinds: those designed to prepare for the changes which are to take place and those designed to adjust their impact once they begin to be implemented. We consider the first kind to be at least as important as the second. We have emphasised the need for local authorities to be able to plan ahead and in particular for the level and distribution of grant to be established as far ahead as possible. It follows that any changes stemming from our recommendations should be fully worked out and discussed with local authorities well in advance of their introduction so that both the government and local authorities have ample time to consider their impact on expenditure plans and local tax rates. It is therefore important that the implementation of changes should not be hurried. Those which are introduced should be employed for the purposes they are intended to serve and not used to serve other purposes as well. Individual measures should not be introduced piecemeal but should be considered in relation to other changes both in local government finance and in national taxation and other policies, so that their total effects can be considered together. The expected effects should be made clear so that accountability is not undermined by their being confused with the effects of other decisions.

38. No amount of careful advance planning, however, will overcome the fact that, if changes are made to improve the lot of some people, others will be left worse off. The use, for grant distribution purposes, of income as a measure of domestic taxable resources, the use of capital values for domestic rating assessments and the rating of agriculture will all have a major impact on rate bills. If detailed examination of the general effects of these measures in due course shows any of them to be undesirable, their application may need to be modified. But even if these effects are acceptable in the longer run, it may be

desirable to mitigate their immediate impact. If so, the application of particular measures which may be thought to create difficulties should not be amended, but separate action should be taken to limit the increases in any individual's rate bill over a period which may result from all the changes taking place.

ALTERNATIVE SYSTEMS

39. We now describe arrangements which would be appropriate to the assumption, by the government or by local authorities, of the main responsibility for local government finance. In either case it is feasible to devise a system which could meet the main requirements we set out in the earlier chapters of our report.

Central Responsibility

40. If the government assumed the main responsibility for local government expenditure, it would set the totals for local spending within fairly narrow limits. It would have to determine how much each authority was to spend and for what purpose. There would still be some scope for discretionary expenditure and a local tax would still be needed to finance it. The rates would be quite adequate for this purpose. The balance between rates and grants would be decided by the government on the basis of its judgement of what level of property tax would be desirable in the context of the total taxation system. There would still be some room for local authorities to vary their rate poundage to pay for discretionary expenditure. But the government would decide what rate poundages it expected local authorities to levy and any departure from these poundages would be clearly identifiable as the responsibility of the local authority.

41. A unitary grant based on a prescription of the approved expenditure of each authority and a standard proportion of local taxable resources would be the most appropriate form of grant in this context. Although statistical analysis might still play some part in the process, the aim would not be to match expenditure needs as reflected in the existing pattern of expenditure but to allocate the resources available on the basis of a judgement of each authority's expenditure plans. The grant would therefore be calculated on a service by service basis, although it would still be preferable to pay it as a block grant and leave authorities some discretion over the precise allocation of their expenditure. Payment of grant on expenditure in excess of the approved figure would be confined to an allowance for error in estimating expenditure needs. Both the level and distribution of grant would need to be adjusted frequently. Otherwise changes in the pattern of expenditure or in costs would have a substantial effect on local tax rates.

42. Control of expenditure would effectively be secured through the allocation of grant and, if necessary, limiting discretionary expenditure. To exercise control in this way would, however, probably require the submission of local authority budgets for scrutiny and approval. Where necessary it might mean

adjusting either the grant or the approved items of expenditure in order to ensure that the grant and the yield of the standard proportion of local taxable resources were sufficient to finance the approved expenditure. Control would need to apply to both capital and current expenditure and there would need to be an associated control over borrowing.

43. The method of allocating grant and controlling expenditure would give the government a decisive voice in the policies and priorities of individual services. We have indicated, however, that there are a number of functions which local authorities could exercise with little government intervention, and there would be scope for local discretion in the management of the major services. Local authorities would also be able to influence central government policies through their collective voice in the forum we have recommended and individually through the closer contacts which would be needed with departments responsible for each service. But it would be difficult to reconcile the responsibility of councillors to their electorates for meeting the needs of their areas with their responsibility to the government to implement its policies. There could be particularly difficult problems where the political allegiance of the council was different from that of the government and there was strong disagreement about the policies to be pursued. Major changes would be involved for the government if departments were to be enabled to deal with a large number of local authorities individually—at least all the major spending authorities—in considerable detail and yet be able collectively to develop a coherent view of local authorities' priorities. In England there would probably need to be a considerable strengthening of the regional organisation of some departments for this purpose. The Scottish departments have already gone a long way towards developing this kind of relationship with local authorities and it would not involve major changes in Wales.

Local Responsibility

44. If the main responsibility for the level and pattern of expenditure on local services were to be placed on local authorities they would need to be able to raise a much bigger proportion of their own revenue from local taxation than at present. A local income tax would therefore have to be introduced to supplement the revenue raised by the rating system. It would make for clear accountability and understanding if the major spending authorities levied only LIT and other authorities only rates. But because of the diverse allocation of functions and the other limitations on tax and grant levels such arrangements would mean high rates of LIT and the loss of a considerable part of the potential yield of rating. We therefore propose that all authorities should continue to levy both domestic and non-domestic rates and that the major spending authority in each area should also levy LIT. The government might feel the need to exercise some influence or control over the relationship between the two taxes and they might wish therefore to prescribe the limits within which the authorities with access to both taxes could vary the proportion of revenue raised from each of the sources.

45. The percentage of expenditure financed by grant would be much lower than at present, but there would be considerable room for judgement about the precise balance between grant and local taxation. It would be particularly important that the size of the grant should be determined earlier than now and its distribution stabilised. Because grant would need to be a smaller and more stable element in each authority's finances, grant negotiations would cease to dominate the discussions between the government and local authorities.

46. A unitary grant in this context would have the advantage over the present grant structure of enabling any desired degree of redistribution to be achieved with a lower rate of grant. But the grant would need to be expressed in a form which plainly did not imply that the government was seeking to determine what individual authorities ought to spend and what tax rates they ought to levy. The actual pattern of expenditure would continue to be accepted as the best representation of local expenditure needs. Serious efforts to improve the current methods of measuring local expenditure needs would therefore need to continue. The calculation of expenditure needs would however be used only to determine, in conjunction with the measure of taxable capacity, each authority's rate of grant. The grant would then be paid at that rate on whatever level of expenditure each local authority incurred. There should, however, be some limitation on the amount of grant in order to maintain adequate discipline over local government expenditure and to avoid an open-ended commitment by the government. For this purpose a level of expenditure would have to be specified for each authority, related to its assessed needs, above which the rate of grant would be reduced. This limitation should be settled at the same time as the grant itself so that authorities would know in advance how much grant they would receive in relation to any given level of expenditure.

47. The government must be able to influence the rate of growth of local expenditure for the purpose of economic management. We have emphasised that the exercise of such influence need not and, if there is to be local responsibility, should not be concerned with the allocation of expenditure between services. The existing detailed methods of control through loan sanction and the level of grant would therefore be inappropriate. If the grant is organised as we have recommended, local accountability, coupled with a much better understanding between the government and local authorities, should provide a stronger discipline than at present over local government expenditure and should contribute to economic stability. Nevertheless, we propose that the government should have at its disposal instruments designed to exert a powerful influence over the growth of expenditure and its allocation between capital investment and current expenditure. The precise form of any new powers would depend on the financial structure within which they would operate but any proposal to change the degree of restraint being exerted should be subject to affirmative resolution of Parliament. Possible powers include requiring local authorities to raise additional taxation to finance increases in expenditure beyond a prescribed margin and prescribing the proportion of capital expenditure to be financed from revenue. We believe that instruments of this kind could provide a flexible

means of influencing the growth of expenditure which could if necessary be applied severely when the economic situation required it without at the same time undermining local accountability.

48. The government will also have its own views about the development of individual services and their priority for expenditure. But it should seek to achieve its objectives by achieving a close understanding with local government rather than by detailed intervention and administrative control. Ministers with responsibilities for services which are administered by local authorities would have to be prepared to accept a less dominant role. An act of political will would be required to allow local authorities greater freedom to decide their own priorities and act accordingly. Where necessary specific legislation should be introduced to promote or alter policies when the government considers that to be essential.

Implementation

49. More explicit central control could be introduced fairly quickly. There has been a drift towards increasing government intervention for many years and many of the means of control are already available. The main new requirements would be to assess the expenditure plans of each authority and to provide that grant would be based on a prescribed figure. Some redeployment and perhaps some increase in staff would be needed.

50. A move to more local responsibility, on the other hand, would depend on the introduction of local income tax, which could not be achieved in less than five years. The need for the transitional arrangements to be carefully worked out along the lines we have suggested in paragraphs 35 and 36 above would be particularly important. The amount that a given rate of tax would yield in each area, the new level of rating and the amount of grant to be paid would have to be worked out so that local authorities could decide what tax rates would be required to finance their expenditure and the government could decide what adjustments were necessary in its own taxation. The amount of money at stake would be very large and any miscalculation could have serious consequences.

51. In the meantime, it would be necessary to improve local accountability and some short-term measures would need to be taken to that end. The first requirement is that the grant should as far as possible be stabilised. We welcome the decision taken in making the grant settlement for 1976/77 to phase changes in distribution over a period of three years and to give advance notice of the level of expenditure on which the grant would be based. The grant should be fixed as far ahead as possible and in order to enable individual local authorities to plan their expenditure they should be given advance notice of the basis of distribution for later periods. Additional grants of a temporary kind should be introduced to compensate local authorities for unforeseen additional expenditure arising from new policies or newly-recognised or special needs. In

future Public Expenditure White Papers the implications for local government expenditure should be made clear.

52. Local authorities should be given more discretion over the way in which money is allocated between services and over the purpose for which loan sanctions are applied. The level of expenditure qualifying for grant will be based on the government's policies for local services, which will be set out in Public Expenditure White Papers. Nevertheless the government should refrain from issuing circulars and statements thereafter giving local authorities detailed guidance on how much money has been allowed for each service and how it should be spent.

53. These short-term arrangements would mean that the level of local expenditure would be determined by the accountability of local authorities to their electorates for the amount of rates they levied. Changes in grant distribution or the rating system that would obscure the relationship between spending and rate burdens should be avoided.

Devolution

54. We have noted throughout our report that local government in Scotland, and to a lesser extent in Wales, has features which differentiate it from England. In Chapter 5 we consider how the choice between central and local responsibility might affect Scotland and Wales and whether they would necessarily have to make the same choice. The government's proposals for devolution were published at a late stage in our inquiry and are still open to change before they are enacted. The proposed role of the Assemblies in relation to local government is based on the existing relationship between the government and local authorities. If the nature of that relationship changed it would raise the questions whether a similar choice had to be made in Scotland and Wales and whether the arrangements proposed at present should be modified.

55. The White Paper proposes that the sources of local revenue in Scotland and Wales should be the same as in England. Local authorities in Scotland and Wales would therefore not have access to a wider tax base than those in England. In the absence of this essential requirement it would not be possible for the Assemblies to introduce a wide measure of local accountability. This choice would require the introduction of LIT. If LIT were introduced in England the case for introducing it in Scotland and Wales as well would be very strong. The financial arrangements we have proposed would be suitable for this purpose. However the introduction of LIT would not require the Assemblies to allow more local responsibility. They would have a choice.

56. Enlarging the tax base of local authorities would also enlarge the tax base of the Assemblies who would have power to levy a surcharge on it. The possible implications for devolution of giving the Assemblies access to LIT go beyond the scope of our inquiry, but it is a factor which the government will need to take into account in considering our proposals. What is important from our

point of view is that the levy of a surcharge on LIT, as well as on rates, would blur its perceptibility as a local tax and so make it difficult to achieve the clear accountability which is an essential feature of more local responsibility.

London

57. London should be treated in the same way as the rest of the country and the requirements of accountability and fairness should be met. However, the different division of functions and the great disparity in needs and resources both between London and the rest of the country and within London itself make it necessary to devise special arrangements for London within any financial framework. Many of the changes we have recommended would mean a departure from the present arrangements for London as a whole and would also affect the present financial arrangements within London. A great deal will depend on the detailed application of possible changes. The range of choice and the combination of possibilities is very wide and we were unable to consider their combined effect on London. But it will be necessary for the government to do so in consultation with the London authorities once a decision is taken on the main proposals for local government finance.

MAKING THE CHOICE

58. We have suggested that the main responsibility for local expenditure and taxation should be placed either upon the government or upon local authorities. Each of the alternatives we have posed would provide a flexible basis for financing whatever level of local expenditure is considered desirable in future. Each would enable a fair and acceptable incidence of taxation to be achieved. In each case the responsibility for expenditure and taxation would be clear. The choice between them turns on what importance is attached to a few decisive administrative, economic and political issues.

59. First, introducing LIT is a necessary condition of greater local responsibility. The total public and private costs may well amount to about £100 million a year. The Inland Revenue would need to employ over 12,000 more staff. Such an increase in cost is not the most obvious way of setting out to achieve better value for money in public administration. But this cost has to be considered in the context of local government expenditure of some £13,000 million a year¹ and the employment of nearly 3 million staff. The large and measurable cost of LIT has to be weighed against a judgement of the intangible but possibly greater gains which might be achieved in the use of these great resources.

60. Additional costs might also be involved if the government assumed greater responsibility. The preparation, scrutiny and co-ordination of budget proposals might involve some increase in staff for both government departments and local

¹ Estimated gross expenditure in Great Britain in 1975/76 financed from rates, grants and income from fees and charges.

authorities. More important, however, is whether more central control would lead to more burdensome administration at both levels of government. With an explicit chain of responsibility it is probable that much of the effort which at present goes into argument and persuasion could be reduced. But there would inevitably be a danger that, whatever the initial intentions, more detailed involvement by government departments would both increase the cost of administration and reduce its efficiency. There would also be a diversion of the energy and resources of Ministers and their departments from the tasks which only the government can perform.

61. The second main issue is the implications for economic management. If the government assumed responsibility it would effectively set the level of local government expenditure and would be able to ensure that it was not exceeded. But in doing so it would have to reconcile local needs and circumstances with the resources to be made available. The government would be subject to all prevailing pressures for increased expenditure. Local authorities would be making competitive bids for expenditure. Although they would still be concerned to make the best use of the resources available to them, they would be likely to pay more attention to obtaining more grant than making difficult choices about their own priorities. The Ministers responsible for individual services would be subject to even more pressure and we believe it might be difficult for the Treasury to hold the growth of local expenditure to a level consistent with other economic objectives.

62. If local authorities had the main responsibility the control of expenditure would depend greatly on the perceptibility of increases in LIT and the effectiveness of accountability to local taxpayers reinforced by the management of the grant. As compared with the situation described in the last paragraph, much would depend on whether local authorities would find it easier to persuade the government to pay more grant or their taxpayers to pay more tax. Much would also depend on how well local authorities would respond to the government's view of national requirements. Government powers to limit the expenditure which could be financed from increased local taxation would provide a powerful restraint on local authorities. These powers could be exercised solely on considerations of economic management without the Treasury being subject to pressure from spending departments for specific expenditure proposals.

63. The third, and perhaps the most important, issue is whether all important governmental decisions affecting people's lives and livelihood should be taken in one place on the basis of national policies; or whether many of the decisions could not as well, or better, be taken in different places, by people of diverse experience, associations, background and political persuasion. Local authorities are able to consider the needs and circumstances of their areas as a whole and respond to the preferences of people living there. There has been a growing demand for decisions to be taken closer to the people who are affected by them. We have pointed to the essential role of local authorities in enabling

people to take part in decisions about the services and amenities in their areas, in promoting democracy, in acting as a counter-weight to the uniformity inherent in government decisions, and in providing a vehicle for formulating new policies and pioneering new ideas.

64. Governments on the other hand are elected with a programme to carry out national policies which may cut across local preferences. There are powerful pressures in society for more uniformity of provision, stimulated and expressed by well-organised and informed bodies of professional and other interests. From the point of view of organisations concerned with the welfare of the aged, the disabled or the homeless, variations in standards between one area and another are seen not as the legitimate outcome of local choice but as anomalies in the provision of services which happen to be administered by local authorities. Ministers who are subject to these pressures and who are anxious to implement their electoral commitments are also impatient of local choices which do not accord with their policies.

65. The pressures for uniformity are felt by local authorities also. While local responsibility would allow scope for the provision of services in some areas to advance faster than in others, it would not necessarily lead to wide disparities. But the standard or extent of local services and the level of local taxation would be determined to a much greater extent than now by the decisions of individual local authorities and could vary more widely between areas of differing social composition and political control.

66. Much turns on the value which is placed on local democracy itself. Central responsibility would tend to undermine the role of the local councillor. Most of the contact between government departments and local authorities would probably be between officials. Local government officers would therefore tend to regard themselves as increasingly answerable to government departments rather than council committees. In such circumstances it would be difficult to predict what the full consequences of adopting explicit central accountability would be upon local government that has been developed from an historical basis of local accountability by locally elected members. But it is likely that the main role of councillors would be to press the government for more grants to meet the needs of their areas. Shortcomings in local services could be blamed on the inadequacy of the grant, as they are increasingly at present. Ministers and their officials would become answerable to Parliament for local services. While local authorities might still retain a measure of discretion in the provision of services, their role would be a delegated form of local administration for which political responsibility clearly rested at the centre.

67. The choice we have posed is a difficult one. It is not for us to make it. It will have to be made by the government on a careful assessment of a wide range of administrative, economic and political issues many of which go beyond the scope of our Report. There is a strongly held view amongst us that

the only way to sustain a vital local democracy is to enlarge the share of local taxation in total local revenue and thereby make councillors more directly accountable to local electorates for their expenditure and taxation decisions. On balance, we consider that the administrative cost involved in introducing a local income tax for this purpose would be justified. After many decades of uncertainty in the realm of local government finance the time has come for a choice on the issue of responsibility.

NOTE OF RESERVATION

By Professor Alan Day

1. While agreeing with most of the broad structure of the analysis of the problems of local government finance in the Report, I consider that it is necessary for the sake of informed public debate that attention also be paid to a number of judgements where it may be appropriate to lay somewhat different emphasis from that in the Report itself. The emphasis of my own interpretation of the problem is based on the assumption, which I entirely share with my colleagues, that it is essential that financial responsibilities be clearly defined, and on the interpretation of the developing situation which I also share with my colleagues that there is undesirable confusion about the respective responsibilities of local and central government. It is also based on a belief in the paramount importance of what the Report describes as accountability, which is defined in paragraph 3 of Chapter 4 as occurring where "whoever is responsible for deciding to spend more or less money on providing a service is also responsible for deciding whether to raise more or less taxation".

2. The essential difference of emphasis between my own analysis and that of the Report concerns central-local relationships. The Report is structured around a polarisation between two possible sets of financial structure, one relatively centralist and one relatively localist. The need is seen for a clear act of choice between these two. In my judgement, neither the evidence nor the logic of the arguments is such as to justify this dichotomisation. It appears to me that what was a useful working hypothesis at a certain stage of the Committee's deliberations has unjustifiably been frozen into something of a dogma. In my judgement, there is a continuum of choice about policies, in which various versions of a middle way between the two poles deserve serious consideration. Since it could well be the case that the government will be reluctant to make a choice between the two poles, and since any attempt to achieve a middle way without a clear and explicit analysis of the difficulties involved is likely to lead to a continuation of the existing confusion about responsibilities, it appears to me important to attempt to identify how a satisfactory middle way might be achieved. The British political system is not one which readily accepts polar solutions. In the event, some compromise is likely. The danger is that the compromise will continue to be one in which there is confusion about responsibilities. For this reason, it is a pity that the Committee has found such difficulty in making useful recommendations about a middle way.

3. One explanation of the difference of emphasis of judgement between this note and the Report arises from a substantial difference of emphasis in the explanation of the history of recent years. In that period, the government has repeatedly asserted its wish to maintain the independence of local government, and has introduced mechanisms (such as block grants and the reorganisation of local government) designed to achieve that end. Yet in the event there has been

a continuing movement towards greater central control. The Report, while recognising the existence of nationwide political pressures towards higher levels of public expenditure on services provided by local authorities, concludes that "financial pressures seem to have been critical in tipping the balance of . . . forces towards the centre", and "that the key . . . lies in the weakening of local accountability brought about by . . . the tendency for government grants to grow as compared with the contribution from local taxation, and the natural concern of the government with the total of local government expenditure" (paragraphs 21-2 of Chapter 5). An alternative hypothesis, which is equally consistent with the evidence, is that the rising proportion of government grants has primarily been the consequence (rather than the cause) of a growing desire of the government to achieve rapid rises in the standards of local government services, in face of a situation where the government was aware that it could not put pressure on local authorities to impose substantial additional real burdens of local taxation, particularly on householders. The tendency towards a rapid growth in local government expenditure has been reinforced by inadequate forecasting and controls over aggregate spending, largely arising from confusions about responsibilities.

4. This difference of emphasis on the primary direction of cause and effect, in an extremely complex set of interrelationships, has significant implications for the emphasis in any consequential recommendations. Insofar as the interpretation of the Report is correct, a change in financial mechanisms towards greater self-financing by local authorities could be expected to alter the relative degree of autonomy over policy enjoyed by local authorities and the government. On the other hand, insofar as the development of financial mechanisms has been the consequence of developing national concern with rising national standards, it is less realistic to expect that such an alteration in financial mechanisms (as in the localist model in the Report) would in itself achieve the aim of preventing a steady movement towards centralism.

5. I believe I am not justified in taking a political judgement between centralism and localism, but rather that the Committee's task was to propose financial mechanisms which would ensure that financial accountability clearly lies wherever responsibility for policy lies. In order to do this, one thing that is necessary is to try to make judgements about developments in the next few years. In the longer term, the financial structures should, as the Report argues, be capable of adjustment to a wide range of political situations. But any recommendations which are likely to be unduly difficult to carry out in the circumstances of the medium term are likely to prove nugatory. Here again, public debate of the issues may be helped by laying emphasis in somewhat different directions from the analysis in the Report.

6. Two factors appear likely to be of dominant importance in the next few years. One is a continuation of national concern with raising national standards of those services provided by local authorities. This would be a continuation of past trends. The other factor, which would imply a substantial shift in past

trends, is that it is most unlikely in the short or medium term that the rapid rise in the share of GDP absorbed by the local authority sector can continue, and that it is more than likely that this share will have to fall. This is, indeed, the intention of the 1976 White Paper on Public Expenditure¹, published at the time that this note was being drafted. Taken together, in the context of current financial mechanisms, these factors are (as the Report suggests) likely to lead to a continuation of some trend towards centralism. I am more sceptical than the Report about whether a continuation of this trend will destroy local accountability to the electorate (Chapter 5.23). Nor do I see any persuasive reason why the increase in central control which is likely with present financial structures and under likely political and economic circumstances, would "probably require the submission of local authority budgets for scrutiny and approval" (Chapter 15.42). Moreover—and perhaps to a greater extent than many of my colleagues on the Committee—I share the considerable scepticism which has been expressed in evidence, about the effectiveness of local democracy in achieving an efficient use of resources in accordance with the wishes of the local electorate. (One major source of difficulty here is that the two-party division which still dominates most of national politics is for the most part directly reflected in the same division between the same two parties at local level. This means that, in general and even after the recent local government reorganisation, it is likely in many local authority areas that a considerably greater swing of voters between left and right would be needed to displace the existing party from power than is required nationally, so that a considerable number of local authorities are likely to be dominated quasi-permanently by one or other of the main parties.) Nevertheless, there are undoubtedly important arguments for the view that a substantial further movement towards central control would be undesirable and that preservation of a substantial area of responsible discretion for local democracy is a desirable aim. Without taking any political judgement between centralism and localism, it is therefore appropriate to consider what mechanisms can be designed which would allow a substantial degree of local autonomy and which, in particular, might help maintain something like the present degree of autonomy of local authorities.

7. An important question is, therefore, whether financial mechanisms can be devised where accountability is clearly defined and where a substantial role can be maintained for responsible local government, while accepting the likely macro-economic needs of the government severely to restrain the aggregate growth in local government expenditure, and while at the same time accepting that there are likely to be strong national political pressures for raising standards in the provision of local government services? Is the Report correct in taking the view that a satisfactory half-way house is unlikely to be achievable, between much further centralisation of expenditure decisions and a deliberate revival of local accountability? (Chapter 5.25). The Report rejects solutions based upon either vertical division of financial responsibilities (in

¹ Public Expenditure to 1978/79, Cmnd 5879, January 1976.

which central government would take the primary financial responsibility for some services, for example police and education, and local government take primary financial responsibility for the rest), or horizontal division of financial responsibilities (in which central government would take the primary financial responsibility for defined minimum standards to certain services and local government would take the primary responsibility for any provision in its area above those minimum standards).

8. There are good reasons of principle why such approaches should be most sympathetically considered and why it may be sensible to aim consciously to achieve some such half-way house. A substantial part of the services provided by local authorities has effects on people in the rest of the nation, living outside the area of the particular authority. At least as far as concerns the basic provision of such services as education, police, social services, many environmental services and public housing, the services provided by local authorities can be reasonably interpreted as being national public goods (where costs and benefits are a matter of national concern) rather than local public goods (where costs and benefits are purely a matter of local concern). If this interpretation is correct (and it is entirely consistent with recent history as found in the actions of the government) it is extremely difficult to conceive that in practice the government will forswear responsibility to see that such services are provided at least up to a minimum standard, over the country as a whole. But in terms of the principle of accountability, implying that financial responsibility should be directly associated with responsibility for decisions whether or not expenditure shall take place, it would follow that the appropriate body to carry the ultimate financial responsibility for these essentially national services or minimum standards of service, is the government. This is because the government defines those services and standards and so is to that extent responsible for deciding whether to spend more or less money over the nation as a whole on those services.

9. It is a matter of judgement, to estimate what proportion of the present provision of services by local authorities would, if the government were forced to clarify its position, be explicitly regarded as being nationally desirable. The view of the Committee, that defined minimum standards would account for the bulk of rate fund expenditure (Chapter 5.27), may well be correct. Such a judgement has major implications for any mechanisms which are designed to increase local autonomy: as the Report makes clear, it would be necessary in a system designed to achieve a high degree of local autonomy for power still to be left with the government to achieve its "essential policies" (Chapter 5.42). It is also correct that "experience shows that much more than an agreed set of principles and working rules is needed to bring about the desired result". It is therefore correct that "the fields in which decisions are to be reserved to the government would need to be defined for most services". The Report then argues that "in defining these fields it is important that the matters which the government reserves for decision should be confined to essential issues of national policy and should exclude the wide range of provision where its

intervention is not required to secure the achievement of acceptable standards". At first sight, there might appear to be inconsistency between this sentence quoted from Chapter 5, paragraph 42 and the view of the Committee quoted from paragraph 27 of that Chapter, that defined minimum standards would account for the bulk of rate fund expenditure. The two statements can, however, reasonably be reconciled on the basis of a defensible judgement that if minimum (or "essential" or "acceptable") national standards were defined, they would account for the bulk of rate fund expenditure but would leave a wide range of provision where central intervention was not required.

10. On this basis and on the basis of the principle of accountability, the following statements appear to follow:

- (i) It is necessary that there is a clear definition of essential, minimum or acceptable standards from a national viewpoint—whether the outcome is to be a relatively centralist or a relatively localist solution, or something between the two.
- (ii) Such a definition would probably mean that the bulk of spending would be nationally-determined but that there could be a wide range of local discretion.
- (iii) The principle of accountability demands that the ultimate financial responsibility lies at the level of government where the decision is made, whether or not to incur a given level of provision of service. This principle does not, however, appear to support the assertion (Chapter 7.17) that "the general rule should be that where there is an element of local discretion the financial burden should remain with local government, whatever the relative proportions of local and national responsibility for the provision of the service".

It in turn follows that the appropriate solution is likely to be a half-way house of the kind the Report rejects.

11. The precise nature of the mix must inevitably depend on the views and actions of the government, which has the ultimate power. Any definition of the mix which gave a considerable degree of local autonomy (which is explicitly the preferred position of most members of the Committee) would be entirely dependent on "an act of political will" on the part of the government "to allow local authorities greater freedom to decide their own priorities and act accordingly" (Chapter 15.48). But it is also essential to recognise that, in the absence of such an act of political will, sustained over the years, the creation of financial institutions which gave greater formal powers to local authorities to raise revenue from sources such as a local income tax would be unlikely to achieve any greater degree of effective local autonomy than the political will of the government would be prepared to tolerate. As in the explanation of history (in paragraph 3 above) so with policy for the future: I would lay more emphasis than the Report on causation running from political aims and policies to financial mechanisms, rather than in the opposite direction from financial mechanisms

to political aims and policies. It is desirable to set up financial mechanisms which are most likely to serve the kinds of political aims which can be foreseen. As has been seen with the block grant, the establishment of financial mechanisms which do not accord with the political will of the government can be of little benefit in maintaining local autonomy. In terms of the development of individual services (as it were, from a micro-economic viewpoint) the kinds of political aims of the government which the Report foresees are those outlined in paragraphs 9 and 10. These point towards the desirability of financial mechanisms adjusted to a middle way.

12. This conclusion is supported by the macro-economic arguments outlined above. There can be no question that the government will wish to keep close control (indeed, more effective control than in the past) over the total of local government expenditure¹ so that in aggregate it will be intimately concerned with the financial decisions of local authorities. This concern would be reinforced if a local income tax were introduced, so that local and central government for the first time became direct competitors for the same tax base. The Report, indeed, rightly emphasises that concern with and control over macro-economic aggregates, such as the overall level of local government spending, must rest with the government. This would not necessarily involve difficulties for a solution in which local government had a considerable degree of autonomy over decisions about components of a given aggregate of expenditure, if an entirely clear division could be drawn between macro-economic concern about aggregates and micro-economic concern about components.

13. In principle, this distinction can clearly be drawn. In practice, however, decisions about aggregates are difficult to disentangle from decisions about individual components which account for a significant proportion of the aggregate. This is recognised in the Report. Thus in Chapter 5.32, which is specifically dealing with a 'centralist' solution, it is stated that "in order to decide the totals [of local government spending] the government would need to have a view of the desirability of expenditure on local government services compared with other public spending. The totals could therefore not be set without reference to the purposes of the expenditure." Effectively the same point is made in Chapter 13, paragraph 11 which deals primarily with 'localist' solutions. "In considering what changes in public expenditure may be possible or desirable the government is often faced with a number of difficult decisions. In addition to existing commitments it has to consider proposals for additional expenditure for the development of services. Together these may exceed what the government considers to be the desirable total of public expenditure. It must then consider priorities among local government services. What is more, it must also decide on the relative priorities of local government spending and other public expenditure. Thus it has not only to choose between housing and educa-

¹ At the time of drafting this note a high Treasury official at a press briefing on the 1976 Public Expenditure White Paper described local government finance as it is at the moment as the "Achilles heel" of the Treasury's control over aggregate public spending.

tion but also to consider the importance it attaches to these compared with, say, the National Health Service." The same paragraph of the Report goes on to state that "the critical question of accountability and control of local expenditure is how much further the government should go when it has made known its view on these priorities. If the government insists on securing compliance with its choice of priorities by local government it is well on the road to a centralised system. If the government is content, while having the means to secure compliance with the overall totals, to give local authorities considerable freedom to decide on local priorities between services . . . then greater discretion for local government based on local responsibility can become a reality". I have quoted at some length from Chapter 13, paragraph 11 because it indicates the dilemma which can exist when the government wishes to set the aggregate, relates its view on the size of the aggregate to its views on major components of the aggregate, but wishes to maintain a considerable degree of local autonomy. Suppose, for example, it is determining the size of local government spending, when it ranks additional spending on housing ahead of the National Health Service and in turn ranks additional spending on the National Health Service ahead of education. It cannot then determine the aggregate change in local authority spending it will allow, under a system aiming for local autonomy, without knowing whether local authorities would, if the money were available to them, spend more on housing or more on education. If the government merely made its views known but merely decided to "secure compliance with the overall totals" and "give local authorities considerable freedom to decide on local priorities" the end result could be that there was an increase in public expenditure on education, when the government would have (*ex hypothesi*) preferred an increase in spending on the National Health Service. Another way of expressing the same dilemma is that the aggregate of local government expenditure is the aggregate of a series of major services which happen to be administered by local authorities. The government has no particular reason to be concerned with the size of this aggregate *as such*; its concern is on the one hand with the size of the broader aggregate of the whole of tax-financed public expenditure, and on the other hand with the narrower aggregates of expenditure on each of the various services.

14. The way out of this dilemma which is consistent with a substantial degree of local autonomy and a substantial degree of central control over the aggregate of public spending, and with appropriate financial responsibility, lies through the middle way, which is rejected in the Report. Briefly, the government would determine the minimum standards (including changes in minimum standards) for each of the services in which there is a national interest and would be responsible for their financing. Beyond this it would allow (or for that matter, encourage) local authorities to raise and spend money to an extent determined by its view on macro-economic conditions and for whatever purposes local democracy might determine, within the statutory powers of local authorities. In some services, the national minimum standards might also be maxima; in such cases there would be the vertical division of responsibility to which reference

is made in paragraph 7 above. In other services, the government's view might be that local electors should be free to choose whether or not to enjoy and pay for standards of service above the minima; in such cases there would be the horizontal division of responsibilities to which reference is made above. The government would then be taking two sets of explicit decisions. In the first place, it would be deciding what level of collective expenditure was nationally desirable, both on nationally-provided services and on services provided by local authorities. As a complement to this, it would be deciding what level of expenditure was not nationally desirable and was therefore available either for collective choice locally or for the free choices of individuals about how they spend their disposable incomes. In the second place, it would, by imposing some degree of control over the total of local government spending, thereby be imposing some maximum limits to the aggregate of collective expenditure whether determined nationally or locally. It would thereby be preserving some minimum to the total of expenditure which would be available for the individual to determine himself.

15. While, as has been seen, any satisfactory system must involve a clear definition of the respective roles and responsibilities of central and local government, there can be no doubt that any such definition (under any system, whether towards the centralist pole, or towards the localist pole, or a middle way) would not be an easy task. It would certainly take time, including parliamentary time for considerable statutory changes. As is shown by the researches done for the Committee, the statistics and the statutes, statutory instruments and government policy guidance that are available do not currently allow such definition. This is hardly surprising: no precise definition has been attempted and therefore none exists.

16. One major problem in definition of standards which applies under any system is rightly emphasised in the Report (Chapter 5.29). In the initial stages any minimum standards would be likely to be defined in terms of *inputs* (for instance, the number of staff required) rather than in terms of the *output* of the service produced, (for instance, the amount of educational benefit acquired by pupils) even though it is clearly the output measure which is the more desirable. This aim is difficult to achieve, because of the difficulty in measuring the output of unmarketed services in the public sector. There are two implications of this. One is that the case is reinforced for whatever transfers are feasible, towards charging a market price for services of local authorities and/or towards voucher systems where users are allowed a degree of choice. In such circumstances, some helpful measure of the value of the output to the user of the service becomes available. A second implication arises from the fact that it would be highly desirable, in order to be sure that resources in the public sector are being sensibly used, to achieve reasonably satisfactory measures of the *output* of non-marketed public services. Any arrangements which compelled public authorities to tackle this problem wholeheartedly and seriously would be very welcome for that reason alone. If it becomes necessary to do something, rather

than merely following an interesting intellectual exercise, then administrators have a real motive to try to do it. If the government became explicitly responsible for defining minimum standards of output of local government services and if a major source of local government finance depended on the ability of local government bodies to persuade the government that they were getting a satisfactory output in return for their money, then the pressures to achieve satisfactory measures of output and of productivity changes would be much enhanced. In turn, there is at least fair reason to hope that this process would lead to a greater degree of assurance that citizens are getting value for money for local government services than anyone can be confident is the case today.

17. The Report also emphasises the difficulty in identifying the costs of providing a given standard of service in differing circumstances in different parts of the country. These difficulties are considerable, although it is easy to exaggerate them. They are, for example, handled reasonably satisfactorily in the case of those services, such as the National Health Service, which are nationally provided but where there are significant differences in costs in different areas. Any reasonable approximation to a definition of the cost of providing a defined standard of service in differing circumstances would be a considerable improvement on the present regression equation basis for allocation of the needs element of the Rate Support Grant. As is clear from the Report, the present procedure of attempting to measure need on the basis of statistics of past expenditure has disturbing implications. In my judgement these would become more disturbing if (as is envisaged) a higher degree of local autonomy were to lead to a higher variation of expenditure standards than currently exists. Then 'needs' of different authorities under the grant arrangement, basing needs measures on regression analysis, would increasingly come to be defined in terms of the expenditure decisions that individual local authorities have chosen to make in the past rather than anything that can sensibly be interpreted as 'needs'. To the extent that any system allows genuine and significant local discretion about expenditure and at the same time gives government support for the needs of various authorities, there is an unavoidable requirement in logic for some measure of needs or of the cost of minimum standards which is independent of past expenditure decisions.

18. The Report also lays considerable weight on the judgement that an undesirable consequence, either of a centralist system or of a middle way in which a defined area was clearly the responsibility of the centre, that the pressure of demands from interest groups would be concentrated on the centre. This no doubt is true. But it is also true of any system (even towards the localist extreme) where there is a clearly-defined set of minimum, essential or acceptable national standards. To the extent that these standards are defined (and, as has been seen, it is agreed that they need to be defined under any system) the pressures of interest groups would tend to concentrate on the centre, in order to 'raise' those standards. It is, however, not at all obvious that this outcome is undesirable: indeed it is a necessary concomitant of a clearer definition of responsibilities

than currently exists. It could reasonably be argued that an unfortunate consequence of the present lack of clarity about responsibilities is that pressure groups can take advantage of the confusion to press their cases further than might be done, if responsibilities were defined.

19. A consequence of definition of responsibilities under a 'middle way' solution might well be that local authorities would come to enjoy increasing discretion over some services at the expense of reducing it over others. In the opinion of the Report, this "would not be helpful" (Chapter 7.13). I find it difficult to accept this view, except on the premise that any reduction in local discretion is undesirable.

20. There are two further questions about the principles of grant distribution which arise here, where I have to express reservations about the conclusions reached in the Report. One concerns the view that the government grant should, in a system involving substantial local discretion (which would include both the middle way and the localist solution), be designed so that local authorities which took the discretion to increase expenditure would receive grants enabling "authorities with high and low taxable resources alike to vary their levels of service without widely differing local tax burdens" (Chapter 12.75). This implies a continuation (subject to "limits") of arrangements such as those which exist whereby most authorities which choose to raise their rate poundage thereby receive more grant. In other words, most authorities can increase their expenditure at the margin, at a cost to their ratepayers which in aggregate is less than the aggregate amount of the additional expenditure. The balance comes from government grants which in effect themselves pay a contribution related to the additional poundage. I have great difficulty in reconciling a recommendation that arrangements such as these should continue, with the principle of accountability. If a local authority (and ultimately its voters) decides to spend more or less money, it is logical that those who make the decision should pay (or not pay) the additional money in local taxes. In economic terminology, a logical corollary of the accountability principle is that those who collectively decide to get the marginal benefit of making additional expenditure should pay the marginal cost. Otherwise, local responsibility for the consequences of local decisions is not as well allocated as it might be.

21. The second question about the principles of grant distribution where I have to express reservations about the conclusions of the Report arises in connection with the proposal that the taxable resources of a local authority shall be measured, for purposes of grant distribution, not in terms of the actual tax base of the authority, but in terms of the average incomes of the residents in an authority's area. The argument (Chapter 12.40) for this conclusion is that "property values are particularly weak as a measure of the ability of people in different areas to pay taxes. There is no other commodity subject to taxation whose price differs so materially from area to area and which, with a common rate of tax, would produce such an uneven geographical incidence of taxation.

Moreover, these variations cannot be offset by other features of the tax system". To the extent that they are valid, these are arguments against any property tax, or at least for a considerable restriction in its overall impact. I can see no logic in proposals which accept a role for a property tax and then attempt, by methods which will have arbitrary effects and will be incomprehensible to many people, to modify it towards a collective income tax.

22. The broad nature of the structure of a financial system for a middle way is spelled out in the Report and any detailed specification of the system must largely depend on the clarification by the government of those standards which it regards as national and of the areas where local discretion is desirable. Since the territory covered by the middle way is in its nature a continuum, with the possibility of greater emphasis (now or in the future) towards one pole or the other, any precise specification of financial mechanisms would be inappropriate. It is, however, now necessary to indicate the nature of these mechanisms.

23. The Report makes a powerful case against the continuation of block grants at as high a percentage as currently exists and in favour of a degree of stability of grants. In a middle way solution, these arguments remain equally valid. Insofar as grants are not specifically tied to the financing of minimum national standards, it is desirable that they should account for a smaller proportion of local government spending than currently. Insofar as grants are paid to finance the provision of minimum national standards, there is a case (subject to what is said below) for specific grants to be paid to local authorities at or approaching 100 per cent of the estimated cost. (A high percentage of somewhat less than 100 (say 90) might well be appropriate in such circumstances, in order to provide incentive to the efficient use of the moneys). In such circumstances, since national needs would explicitly be financed nationally, the block grant would become predominantly or wholly a grant designed to promote any necessary equalisation of the resources of different local authorities so that they could provide the same basic standard of provision of services at the same local tax rates over the country as a whole.

24. It is, however, quite possible that the principle of accountability for the provision of minimum national standards might appropriately be consistent with collection of the taxes to finance those standards by local authorities themselves, subject to the continuation of government grants to equate for resources and also for needs. The accountability principle demands that the ultimate financial responsibility lies at the level of government where the decision is made whether or not to incur a given level of provision of service. It could, however, be quite consistent with this principle for the government to delegate to local authorities the responsibility for imposing the necessary taxes. The government might then announce each year a rate of local tax which it considered was necessary for financing the basic minimum national standards. This would be a uniform rate over the whole country, since local variations in

resources and needs would be met from grants. The main disadvantage of such arrangements is that they might lead to slightly more confusion in the understanding of the correlation of responsibility for finance and responsibility for decisions. The main advantage is that such arrangements would reinforce pressures towards efficiency and economy in the local provision of basic national standards.

25. To the extent that the government were to delegate to local authorities the responsibility for imposing the taxes needed to provide minimum national standards, it would almost certainly be necessary for local authorities to have access to a new source of tax revenue, additional to the rates. There can be no doubt that the appropriate source would be a local income tax. To the extent that the greater part of the financing of minimum national standards (and also of those services where minima are also effectively maxima) was to come from specific grants, the need for a new local tax base would be much reduced. In such circumstances, it might reasonably be concluded that the local property tax was an adequate basis for financing some very limited part of the provision of minimum national standards and also for financing the discretionary element in local spending.

26. It follows that the case for and against the introduction of a local income tax must largely depend on the answers to two questions. One concerns the proportion of total local government spending which would be within defined minimum national standards. To the extent that this proportion were high, the case for a further local tax base is so much the smaller. The second concerns the judgement about efficiency and effective accountability between a system where most of the finance for basic standards came from grants and a system where most came from taxation delegated from the government to local authorities. To the extent that the latter were preferred, the need for a further local tax base would be so much the stronger.

27. In addition, the argument for and against a local income tax must largely depend on judgements (which have to be made by the government) about the balance in the overall tax system (national and local taken together) between taxation on real property and other taxation. There are two persuasive cases (to which some reference is made in the Report) in favour of a situation where a significantly smaller proportion of the overall tax bill is paid in property taxes, and where a significantly larger proportion is paid in other taxes. (These other taxes need not, *overall*, be net additional income taxes; they could for example be additional VAT or corporation tax, with any required local income tax being offset by a reduction in national income tax rates). One of these arguments for a lower level of property taxes in the overall tax system arises from the regressiveness of property taxes at low income levels. This is currently met by rate rebates. But rate rebates are a major contributor to the extreme steepness of effective marginal tax rates around the level of the so-called 'poverty trap'. It could be that a substantial reduction in rates (property taxes) would allow a

considerable modification of the rate rebate system and even its disappearance. The second argument for a lower level of property taxes concerns rates on commercial and industrial premises. As the Report makes clear, rates now account for a remarkably high proportion of the total taxes paid by commerce and industry. The economic effects are of very questionable desirability. Moreover there is some reason for concern (in terms of the principle of accountability) about a situation where a large proportion of the burden of local taxation is borne by ratepayers who have no direct influence on the spending decisions of their local authorities. The Report is right in taking the view that the liability to pay local rates does create a desirable element of concern with local government decisions on the part of commerce and industry. Nevertheless, it might well be more satisfactory if the rate burden on commerce and industry could be reduced substantially.

28. For somewhat different reasons from those argued in the Report, it therefore does appear to me that there is a considerable case for a local income tax.

29. Finally, there is the question of the appropriate macro-economic controls over aggregate local authority spending in a system following a middle way. Since a substantial, and perhaps much the greater, part of local government expenditure would be the financial responsibility of the government, the remaining problem of macro-economic control might be expected to arise in connection with the limited (but possibly substantial) range of expenditure subject to local discretion. The suggested techniques outlined for a localist solution in Chapter 13 (namely a regulator by which the government could impose taxes on excessive tax increases by local authorities, an imposition of a ratio of capital expenditure which had to be currently financed, and various direct controls over borrowings) could also be helpful in a system based on a 'middle way'. In such a system, however, there is no obvious reason against giving the government powers to impose direct controls over changes in rates of local taxation (which is rejected in paragraph 47 of that chapter). Circumstances might well arise in which the government wished to impose severe macro-economic restraints on the growth of discretionary local government expenditure. If reliance were placed solely on the kind of regulator advocated, it might be necessary to threaten the imposition of a penal rate of central taxation on any local authority which wished to make substantial increases in its spending. One consequence could be, in circumstances where a local authority chose to be obdurate about increasing its spending, that local taxpayers would find themselves paying a sum of money in additional local taxes, well in excess of the total additional expenditure of their authority. Direct controls over changes in local tax rates could be a much more satisfactory technique than devices which could lead to an outcome such as that just described, both in terms of political and administrative practicability and in terms of the accountability principle.

30. In spite of these reservations about the Report, I consider it essential not to lose sight of the many valuable insights into the strengths and weaknesses

of the present system which are to be found in the Report and not to ignore the many recommendations in the Report for the many changes which are in no way contingent upon acceptance of the polarisation hypothesis. Indeed, one of the dangers I see in the way the Report is structured around that hypothesis, is that it might distract attention from these very recommendations.

Annexes

NOTE OF RESERVATION

By Professor Gordon Cameron

On every point except one—the rejection of a standards approach for the clarification of financial accountability as between central and local government—I am in full agreement with my colleagues on the Committee. However the standards approach appears to me to be such a promising field for devising financial mechanisms which would clarify the respective service-providing roles of the two tiers of government that I am compelled to disagree with the views of my colleagues on this one point. I find that my views on this subject are best expressed by Professor Day in his note of reservation, paragraphs 7 to 19 inclusive and I therefore wish to be associated with these paragraphs.

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